CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL
SOUTH ZONAL BENCH
BANGALORE

Appeal(s) Involved:

C/443/2005-DB & E/417/2007-DB

[Arising out of:

(i) Order-in-Appeal No. 41/2004 Cus. Adjn. (Commr.) dated 12/11/2004 passed by Commissioner of CUSTOMS, BANGALORE.

(ii) Order-in-Appeal No. 5/2007 dated 15/03/2007 passed by the Commissioner of Central Excise, Bangalore-I Commissionerate.]

M/s. United Telecoms Limited
No. 88 Part-1, EPIP
K. R. Puram Industrial Area,
Whitefield,
BANGALORE.
KARNATAKA

Appellant(s)

Versus

Commissioner Of Central Tax,
Bangalore Custom
C.R. BUILDING, QUEENS ROAD,
P.B.NO. 5400,
Bangalore – 560 001.
Karnataka

Respondent(s)

Appearance:

Mr. B.N.GURURAJ, ADV
"Rathna Krupa" No.20/A
National High School Road,
V.V. PURAM
Bangalore - 560004
Karnataka

For the Appellant

Mr. Veerabhadra Reddy, AR

For the Respondent

Date of Hearing: 25/03/2019
Date of Decision: 28/03/2019

CORAM:

HON'BLE SHRI S.S GARG, JUDICIAL MEMBER
HON'BLE SHRI P. ANJANI KUMAR, TECHNICAL MEMBER

Final Order No. 20292 - 20293 /2019

Per : P. ANJANI KUMAR

The brief facts of the case are that, the appellants have entered into a contract with BSNL for supply of 372.10 K of MSC based WLL CDMA equipment along with associated equipment and accessories. The purchase order given to the appellants also put a condition that the WLL equipment along with associated equipment etc shall be of usage technology of China. Accordingly, the appellants have imported the material from ZTE, China and filed Bills of Entry 7261 and 7262 both dated 17.8.2004. Commissioner of Customs has confirmed the differential customs duty of Rs.3,11,24,534/- on the WLL CDMA equipment and customs duty on other items of import like computers, cables, printers and training model BTS and has also imposed penalty of Rs.50,00,000/- under Section 112 of the Customs Act, 1962.The appellants have filed an appeal No. C/443/2005 against such order. The appellants thereafter have got the equipment released and after undertaking certain processes and have cleared the goods to M/s. BSNL. However, the appellants have split the pricing into hardware and software component and paid duty on the hardware component only. An audit of the appellants was conducted, the appellants have been issued a show-cause notice demanding differential duty on the alleged artificial splitting of the price of goods supplied to BSNL. Commissioner of Central Excise vide Order-in-Original No.05/2007 dated 15.3.2007 has confirmed Central Excise duty of Rs.2,89,62,572/- and imposed equal penalty under Section 11AC of the Central Excise Act, 1944. The learned Commissioner has held that the software supplied is in the nature of firmware and the value is to be included in the value of excisable goods, as the so-called software is already loaded on the hardware and that, no software has been cleared separately. The appellants have filed appeal No. E/417/2007 against this order.

2. The learned counsel for the appellants submitted, in the case of the Customs Appeal that they claimed no refund of the Additional duty of Customs (CVD) paid as they have already availed CENVAT credit; that they are challenging the imposition of penalty. On the Central Excise appeal, the appellants contended that the learned Commissioner had not considered the Supreme Court's decisions in the case of ***PSI Data Systems Ltd. vs. CCE: 1997 (89) ELT 3 (SC)*** and ***CCE vs. Essar India Ltd: 2004 (172) ELT 289 (SC)*** and sought to distinguish them. He further submitted that the ratio of the constitutional bench judgment in

CCE vs. Grasim Industries: 2018-TIOL-181-SC-CX-CB. He submitted that the Central Excise case was based upon investigation conducted by the customs authorities and words like 'firmware', 'embedded' or 'etched software' were used freely. Learned counsel further submitted that the learned Commissioner has proceeded to decide the excise demand even though it was submitted that their appeal against the Customs Commissioner's order was under challenge before Hon'ble High Court of Karnataka. The department should appreciate the fact that the supplies were to Government undertaking i.e., BSNL. The splitting of software and hardware portion of the value was not with any intent to evade payment of duty but was in terms of the agreement with the BSNL. It can be seen from the invoices issued to the BSNL that the value is shown separately. Therefore, no intent to evade payment of duty can be alleged. He submitted that both the duty and penalty be set aside.

3. The learned authorised representative of the department has vehemently opposed the submissions of the learned counsel for the appellants and submitted that at the Customs Port at the time of clearance and at the time of removal of excisable goods from the appellant's premises, the hardware was only removed. No separate software on any media was separately cleared/removed. Only the hardware onto which the software was already loaded were removed/cleared. It was only in the invoices or bills, the value of software/hardware was separately shown. Therefore, the value payable for the goods was in the condition they were removed from the Port or factory. Therefore, both the Commissioner of Customs and the Commissioner of Central Excise in the respective impugned orders have correctly loaded the value claimed for software. He relied upon ***Anjaleem Enterprises Ltd. vs. CCE: 2006 (192) ELT 690 (SC)***. He further submitted that in respect of the Customs case, the Commissioner had already taken a lenient view in imposing penalty. In respect of the Excise case, he submitted that though the appellants were aware of the fact that their effort to separate the value of software and hardware was not successful before the customs authorities, and though, they have availed Notification No.36/96 dated 23.7.1996, they did not disclose the same to the Central Excise authorities and have given an impression that the hardware and software were cleared separately. Therefore, the intention of the appellants to evade duty was very clear.

4. Heard both sides and perused the records of the case. We find that at the time of import, Customs authorities have found that the goods imported by the appellants were an integrated business of CDMA WLL technology equipment consisting of BTS/BSC/MSC consisting of obvious hardware and software with the software loaded into the hardware. Though the billing was purported to be separate, the Customs Authorities have concluded that the software was not treated separately and there was no separate transaction for the hardware and software and the price paid was an integral price or value for the unit as a whole. Accordingly, the Customs Authorities have charged duty on the imported hardware and software and the same was paid by the appellant and goods were cleared. The Ld. Commissioner of Customs has confirmed the demand of duty. After clearance of the goods the appellants have carried out activities like assembly, inspection, integration, software porting, customization etc and have cleared the goods to M/s. BSNL after quality inspection conducted by the customer i.e. BSNL. Department has contended that a software shown to have been manufactured and removed separately are nothing but firmware etched/embedded/burnt on the flash memory chip of the mother board of the hardware at the point of import itself and thus had become an integral part of the hardware at the point of removal for home consumption and that splitting up of the value and showing it separately as a different commodity or preparing separate document at the time of removal of the equipment is an intention to evade appropriate payment of duty. The show-cause was issued and the same was confirmed by the Commissioner to the extent cited above.

5. We find that the learned Commissioner has relied upon the statement of the company officials namely Shri. B. Sreenivasappa, Chief Technology Officer, Shri. C. Basavapurnaiah, Chairman, Shri. Sharas Chandran Cherukandy, General Manager, Shri. C.P. Suresh, Manager and the officials of ZTE, China and the Commissioner has come to a conclusion that the appellants are the manufacturer of MSC based WLL CDMA 2001 and telephone equipment supplied to BSNL. The appellants have imported BTS/MSC along with antenna and cables and after integration supplied the same to the BSNL. The Commissioner on the basis of dictionary meaning and on the basis of various Court's judgment in **Acer India Ltd.** (supra) has concluded that the "software kept in semi-permanent memory. Firmware is used in conjunction with hardware and software. It also shares the characteristics of both. Firmware is usually stored on PROMS

(Programmable Read only Memory) or EPROMs (Electrical PROMS). Firmware contains software which is so constantly called upon by a computer or phone system that it is "burned" into a chip, thereby becoming firmware. The computer program is written into the PROM electrically at higher than usual voltage, causing the bits to "retain" the pattern as it is "burned in". Firmware is nonvolatile. It will not be "forgotten" when the power is shut off. Handheld calculators contain firmware with the instructions for doing their various mathematical operations. Firmware programs can be altered. An EPROM is typically erased using intense ultraviolet light." We find that the learned Commissioner has relied upon the Apex Court's ruling in ***M/s. Acer India Ltd.*** and ***M/s. Anjaleem Enterprises Pvt. Ltd***. (both supra).

6. The appellants have vehemently contested that the Commissioner has used the word software, firmware, hardware etc without going into the exact nature of the same and used options or alternatives like ROM/EPROM/EEPROM. However, the appellant submitted that what was required to be determined was whether the value of software supplied in whatever mode BT CDS or IT units, form a part of the transaction value. We find that as per the statement of Shri B. Sreenivasappa dated 01.02.2004, the appellants have received information from JTE that they have loaded/embedded the concerned software into the equipment which will be converted and made functional during the integration and testing. The appellants also submitted that in the trade of such items the price includes the component of hardware and software. Sometimes the value of the software may go up to 60% were required to be done by the Department was to challenge the production net instead of doing that the learned Commissioner has held that the software supplied along with equipment was firmware.

7. We find from the facts of the case that the appellants have imported equipment wherein the software was preloaded. There was no separate mode in which software was imported. Therefore, as held by the Tribunal in **Bhagyanagar Metals Ltd. (supra),** the Customs authorities have included the value of the same in the assessable value and the appellants have paid duty on the same and have availed credit of CVD on the same. We find that as stated by Shri. B. Srinivasappa in his statement dated 23.08.2004, the followings are submitted to the manufacturer:

i. Procurement of approved documents along with Bill of Material
ii. Breaking up of BOM
iii. Procurement of all the components
iv. Assembly of cards and sub-assemblies and wiring
v. Inspection and rework of cards
vi. Card level electrical testing, tuning, debugging, parameter adjustments and measurement of card level parameters etc.
vii. Sub system integration and Wiring
viii. Software porting (downloading) and sub system testing
ix. Main system integration and wiring
x. Software porting and testing of complete system
xi. Customisation of software and configuration of the hardware as per the customer requirement (Physical chipset is not being altered, but only function of the chip are modified using software.
xii. Internal quality and QA inspection
xiii. Customer inspection, Final Testing and Billing

8. As per the process undertaken by the appellant, it is seen that they are not making any changes in the chip that is imported. As per the submission of Shri. B. Sreenivasappa, the basic software was along with complete hardware on a separate CD. However, the facts of the case also indicate that no separate CD's/media were supplied and the software was loaded on the flash memory of the chip and IC. No other mode function software was imported and no other mode is being supplied to their customer that is BSNL separately. Therefore, whatever software that has been imported is remained in the system and is not separated before delivery of the equipment to M/s. BSNL. Therefore, the transaction is inclusive of the software that is loaded by ZTE Corporation prior to supply of goods to the appellants for import. We find that this Tribunal in the case of **Bharti Airtel Ltd.** has held as under:

> *"14.2 On a close analysis of the decisions relied upon by both sides, in matters relating to classification/valuation, the following important guidelines/principles emerge apart from the meanings of various relevant technical terms :*
>
> *(a) In classification of products, the commercial understanding is more relevant than technical specifications except in respect of commodities for which such specifications are prescribed requiring the assistance of experts in the respective fields. In other words, the method to be adopted for classification is to be based on easily understandable parameters.*

(b) The decisions in respect of software and hardware in relation to computer are to the effect that if any software is embedded/etched/burnt then it has to be included as part of the hardware and cannot be treated as stand-alone software and that the value of such embedded software should be part of the value of computer. However, it cannot be concluded that only the value of software which is embedded/etched/burnt is to be included in the value of the computer.

(c) It is not as if essentiality is an irrelevant criterion for determining the classification/valuation and at the same time essentiality is not the sole criterion for deciding the classification or determination of value.

(d) In the matter of valuation, one of the important aspects to be taken into account is the condition of the goods/product at the time the goods leave the factory (as held by Hon'ble Supreme Court in para 13 of Anjaleem case). Similarly, in respect of imported goods, the condition of the goods/product at the time of import is relevant.

(e) In certain circumstances, software loses its identity as software and becomes part and parcel of hardware and similarly, in certain circumstances, hardware loses its identity as hardware and becomes part and parcel of software."

9. We also find that Larger Bench of the Tribunal in the case of **Bhagyanagar Metals Ltd.** held as under:

"31. The appellants relied on the decision of Hon'ble Supreme Court in PSI Data Systems Ltd. v. CCE (supra) to submit that the value of the software is not includible in the value of the WLL telephone. In the said case the Apex Court was dealing with tangible software of the nature of discs, floppies and CD-ROMS. It was held that software sold along with the computer cannot be included in the assessable value of the computer for the purposes of excise duty. The Hon'ble Supreme Court cited the example of cassette recorder and a cassette to state that though cassette is required for functioning of cassette recorder, these are two distinct articles. In the present case we are dealing with pre-loaded/embedded software in the memory unit which is an integral part of the Printed Circuit Board inside the Fixed Wireless phone. The reasoning and ratio of the Apex Court in the above decision are not applicable to the present case. In PSI Data Systems Ltd. v. CCE (supra) it was not the contention of the appellants that the firm or etched software that is implanted into a computer is not to be taken into account in the valuation thereof for the purpose of excise duty.

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34. The Apex Court further examined the decision in CCE, Pondicherry v. Acer India Ltd. (supra) and distinguished the same as not applicable to facts of the case of STD - PCO telephones. It was held that the software loaded in the IC Chip, constitutes the 'brain' of the system. The levy is on the unit and not on the programmed EPROM. The programme embedded is not easily removable. Hence, the Apex court held

> *that it will not fall in the category of recorded media under Tariff item 85.24 and remains an IC under Tariff Item 85.42."*

10. The appellants have contested the use of words firmware by the learned Commissioner. Whatever be the connotation of the software the important point to be seen is whether or not the same is preloaded, embedded etc in the equipment. Such a system with preloaded software has certainly more intrinsic value then a system which is not loaded with the same. Therefore, the essentiality test is to see the condition in which the system or equipment is cleared from the factory. In the instant case we find that the equipment were preloaded with the software and CVD was paid on the value which included the value of software. Therefore, such software irrespective of its nomenclature has become integral part of the system or equipment and has enhanced the intrinsic value of the system or equipment. We find that Hon'ble Supreme Court in the case of ***Anjaleem Enterprises Pvt. Ltd. Vs. CCE, Ahmedabad - 2006 (194) E.L.T 129 (SC)*** has observed that- "

> *"13. Secondly, that a computer and its software are distinct and separate is clear, both as a matter of commercial parlance as also upon the material on record. A computer may not be capable of effective functioning unless loaded with software such as discs, floppies and*

C.D.ROMs, but that is not to say that these are part of the computer or to hold that, if they are sold along with the computer, their value must form part of the assessable value of the computer for the purposes of excise duty. To give an example, a cassette recorder will not function unless a cassette is inserted in it; but the two are well known and recognised to be different and distinct articles. The value of the cassette, if sold along with the cassette recorder, cannot be included in the assessable value of the cassette recorder. Just so, the value of software, if sold along with the computer, cannot be included in the assessable value of the computer for the purposes of excise duty."

It is seen that the Supreme Court has affirmed that there can hardly be any doubt with the parts of a components will form part of the final cost of the unit and hence includible in its assessable value.

11. We find that the appellants at the time import have not imported the impugned software separately in the form of CD or any other media. As per the appellants and as per the suppliers the software was pre-loaded on the hardware. Therefore, it will be difficult to see an artificial separation between the software and hardware component of the imported goods. Therefore, we find that the Customs Commissioner has correctly charged the applicable Customs duty on the Transaction value. Similarly, it is not the case of the appellants that at the time of removal of goods from the factory to BSNL, they have separately presented the software, either the one which came along with the imported goods or the one which they have subsequently supplied at the time of manufacture. Therefore, it is to be construed that the value paid or payable for the equipment included that of software and hard ware which were inseparable at the time of clearance from the factory. Arguably, the goods need to be assessed to duty at the time of clearance, in the condition in which they are removed from the factory. We find that the appellants objection on the basis of the use of words like 'firm ware' 'Etched ware" "Eprom" etc., by Commissioner would in no way alter the character of the goods and the fact that the hardware is loaded with software. We find as submitted be the Learned Authorised Representative, that in an analogous situation a manufacturer of excisable goods using either exempted goods or non-excisable goods in the manufacture of excisable goods removed, may claim that a part of the price related to such goods and hence, duty is not payable on the same. Therefore, we find that as held by the Hon'ble Supreme Court in ***Anjaleem's*** case(Supra) The Learned Commissioner has rightly upheld the demand of duty on the goods supplied by the appellants to M/s. BSNL in spite of the fact that the price was split between hardware and software in the invoices.

12. Coming to the other issues involved in the case, we find that the appellants are under a contract with the Government company i.e., BSNL. They have claimed that in terms of the contract, they were billing the hardware and software separately. The Customs authorities have rightly held that the splitting up of value between hardware and software was not correct and the goods must be valued as per the transaction value. The learned Commissioner has confirmed the duty to the tune of Rs.4.08 crores and has imposed penalty of Rs.50,00,000/-. We find that the learned Commissioner has held that keeping in the mind that the goods in question are meant for eventual supply to BSNL, a Government entity, and meant for mobile/wireless communication by public at large, a lenient view can be taken. He has imposed a penalty of Rs.50/- lakhs which comes to around 12% of the duty involved. We find that the same can be further reduced and therefore, we confirm penalty of Rs.25,00,000/- (Rupees Twenty Five Lakhs Only). Coming to the Central Excise case, the appellant claimed that the Department was in the knowledge of the facts that they have been removing the goods to BSNL as per the purchase order issued by BSNL. BSNL being a Government Company, which cannot be alleged that they have colluded with the appellant in erroneously splitting the value of the hardware and software component. We find force in this argument. It is also seen that the appellants have issued invoices containing the stipulated value and claiming exemption on the software part of it. It is also seen that lot of correspondence was going on between the appellants and Departments. Department has forwarded an Annexure-3 dated 14.09.2004 to the Customs authorities for import of goods at concessional rate of duty. Audit was conducted during the month of November 2004 and the same were forwarded to the company vide letter dated 24.12.2004. Further the impugned show-cause notice was issued to the appellant on 01.12.2005 after a lapse of long time. In view of this we find that the appellants' submissions on limitation are valid. No suppression or intent to evade duty can be inferred from the case records and circumstances. Consequently, we hold that the penalty imposed under Section 11AC is not maintainable. Therefore, we confirm the demand and set aside the penalty.

13. In the result, appeal No. C/443/2005 is allowed partially to the extent of limiting the penalty imposed to Rs.25,00,000/- and appeal No. E/417/2007 is also partially allowed to the extent of setting aside the penalty imposed under Section 11AC. Demands in respect of both the appeals are confirmed.

(Order was pronounced in Open Court on **28.03.2019.)**

P. ANJANI KUMAR
TECHNICAL MEMBER

S.S GARG
JUDICIAL MEMBER

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